

**Government of the District of Columbia
Office of the Chief Financial Officer**



Natwar M. Gandhi
Chief Financial Officer

June 28, 2010

The Honorable Adrian M. Fenty
Mayor of the District of Columbia
1350 Pennsylvania Avenue, NW, 6th Floor
Washington, DC 20004

The Honorable Vincent C. Gray
Chairman, Council of the District of Columbia
1350 Pennsylvania Avenue, NW, Suite 504
Washington, DC 20004

Dear Mr. Mayor and Chairman Gray:

I would like to inform you that the revenue estimates for FY 2010-FY 2014 remain unchanged from the February 2010 certification. There are signs that both the U.S. and District economies are in recovery, but every indication is that the recovery is likely to be long and slow. As discussed in more detail below, the May report of cash collections paints a mixed picture for the District's revenue. On the one hand, collections from the April individual income tax filings performed below expectations, and fiscal year to date, the sales and use tax collections have been growing less than expected. On the other hand, the real property tax collections from first half billing was much better than expected, withholding tax collections have performed better than expected since the start of the fiscal year, and growth for the sales and use tax have picked up in the last several months.

Economic Outlook

U.S. Economy

Although the worst of the national recession's impact appears to have passed, or are expected to do so during this fiscal year, recovery appears to be a slow and uneven process. Real GDP has now registered three quarters of positive growth—2.2% and 5.6%, respectively, for the last two quarters of 2009 and 2.7% for the first quarter of 2010—but the economy still appears to be fragile. Growth to this point has been influenced by the national stimulus program and by inventory replenishment; the outlook for sustained recovery in the future remains uncertain. Income growth is still weak and unemployment high.

- U.S. employment (seasonally adjusted) has grown in each of the past 5 months and increased by 431,000 from April 2010 to May 2010. However only 41,000 of the May increase were in the private sector. Since December 2009, the private sector has added just 495,000 jobs, a gain of 0.5%. The number of U.S. wage and salary jobs in May was 7.38 million (5.4%) lower than at the start of the recession in December 2007.

- The U.S. unemployment rate (seasonally adjusted) fell slightly to 9.7% in May, the same rate as in the months of January, February, and March.
- Wages and salaries earned in the U.S. in the March quarter were 0.4% below those of a year ago, although Personal Income (which includes benefits and transfer payments) was 1.9% higher. During the March quarter alone, wages grew 3.2% and Personal Income 3.6% at seasonally adjusted annual rates.
- The Standard & Poor's 500 stock market index in May fell 6.0% from April, relinquishing all gains since January. The market in May was 24.7% higher than a year earlier, but was still 26.9% below its October 2007 peak. The value of the market on the last trading day in May was slightly below the level on the last day of November, six months earlier, reflecting the extent of the recent uncertainty in the market.

D.C. Economy

D. C. economic indicators present a mixed picture. Some, such as government employment and housing sales, show strength, and others, such as private sector employment, unemployment, commercial real estate, and housing prices, show the continued effects of the U.S. recession.

- In May, wage and salary employment in D.C. was up by 7,100 (1.0%) from May 2009. Although federal employment rose by 10,800 (5.5%) from last year, private sector employment fell by 3,300 (0.7%). On a seasonally adjusted basis, private sector employment fell an estimated 1,800 (0.4%) from January 2010 to May 2010.
- D.C. resident employment in May grew by 2,673 (0.9%) from May (seasonally adjusted), the 5th month of growth in a row. In the five months since December, resident employment has increased by 9,635 (3.3%). In May, resident employment was 6,067 (2.0%) more than a year earlier.
- D.C.'s unemployment rate of 10.4% in May (seasonally adjusted) was down from 11.5% in March. The unemployment rate has fallen slowly because the labor force has been growing. D.C.'s labor force was 5,766 (1.7%) more in May than a year earlier.
- The most recent data on wages and income shows improvement in the quarter ending in March. Wages earned in the District of Columbia grew 4.9% compared to the same quarter of 2009, with about two-thirds of the growth attributable to the federal government. D.C. Personal Income was 3.5% above a year earlier, and estimated wages of D.C. residents were up 2.9%.
- In May, single family housing sales (contracts) fell 3.8% from a year earlier, as the first time home buyer credit expired. The average selling price in May was 5.7% less. The average price of condominium units that sold in May was 12.5% above last year's, but sales were down 37.8%.
- In the quarter ending in March, occupied office space rose by 0.8% from the prior quarter and 1.8% from the prior year. At the same time, because of completed new construction, the commercial office vacancy rate stayed at 10.5% (including sublet), still well below the metropolitan area average of 13.0%. An additional 4.1 million square feet are expected to be added to inventory over the next 2 years, outstripping the demand for D.C. office space.

- For the 3-month period ending in April, the average room-rate for hotels was 2.4% higher than for the same period a year earlier, while the number of hotel room-days sold was also up 3.8%. Revenues from room sales were up 6.3%.
- For the 3-month period ending in April, employment in retail was unchanged from a year earlier; employment in accommodations was up 0.5%, and food services down 1.0%.
- Global Insight and Economy.com forecasts for earnings in the D.C. economy have been tending to edge higher, but there has also been uncertainty in the estimates. For example, for both wages earned in D.C. and wages earned by D.C. residents, in May each of the forecasters raised their growth rate estimates for FY 2010 and FY 2011. For Global Insight, however, the May forecast for FY 2010 was still lower than the one made in January, while the Economy.com one was well above the January estimate.

Review of FY 2010 Revenue Collections through May 2010

The report on May cash collections (see summary table below) brings decidedly mixed news on the District's revenue performance for FY 2010.

Sources of weakness:

- Sales tax collections are only just starting to recover from a very weak fall and winter. Year-to-date sales tax receipts are down 4.9% for the fiscal year.
- Individual income tax collections are down 0.8% year to date due weaker than expected performance of final payments from the April filings.
- Nontax revenue is below expectations but does not yet include transfers from special purpose funds that will happen during the close of the fiscal year.

Sources of strength:

- Real property collections are much stronger than expected, growing around 3% fiscal year-to-date through May compared to a forecasted annual decline of 3%.
- Withholding remains strong. Withholding tax collections are up 3.6% for the fiscal year, a remarkable performance given the high unemployment rate for the District's residents since the start of the recession. This suggests that District resident job losses are primarily at the lower end of the income scale, and that higher income District residents are keeping or gaining jobs.
- Sales taxes, after weak fall and winter, are up 2.4% over the past 3 months.
- The steep decline in the deed taxes since the collapse in the housing market is tapering off. All deed taxes are down 30.8% for the fiscal year, an improvement from the almost 50% decline from the previous fiscal year.

Whether or not revenue collections for FY 2010 meet the February 2010 estimate depends on the performance of second half real property tax receipts in September and whether sales and withholding income tax collections maintain their recent momentum.

- A simple calculation of real property using historic ratios of first half to total collections suggests that first half billing is strong enough to completely offset weakness in income and sales tax collections.
- The last three months of sales tax collections, particularly in accommodations, suggest that the last five months of the fiscal year will offset some of the year to date gap. It is unlikely that it will offset all \$31 million.
- Withholding makes up about 80% of the total individual income tax revenue and has been a source of growth for the District. The number of employed District residents has increased for the last four months and for the first time in 14 months is above last year's level. Stronger than projected withholding has offset much of the weakness in non-withholding and could narrow the gap further in the summer months.

I will continue to carefully monitor the revenues and will alert you in the event that the situation changes.

If you have any questions regarding this matter, please contact me on (202) 727-2476.

Sincerely,



Natwar M. Gandhi
Chief Financial Officer

DISTRIBUTION LIST

Councilmember David Catania (At-Large)
Councilmember Phil Mendelson (At-Large)
Councilmember Kwame Brown (At-Large)
Councilmember Michael Brown (At-Large)
Councilmember Jim Graham (Ward 1)
Councilmember Jack Evans (Ward 2)
Councilmember Mary Cheh (Ward 3)
Councilmember Muriel Bowser (Ward 4)
Councilmember Harry Thomas Jr. (Ward 5)
Councilmember Tommy Wells (Ward 6)
Councilmember Yvette Alexander (Ward 7)
Councilmember Marion Barry (Ward 8)
Neil O. Albert, Deputy Mayor and City Administrator
Carrie Kohns, Chief of Staff to the Mayor
Deborah K. Nichols, District of Columbia Auditor
Eric Goulet, Budget Director, Council of the District of Columbia